



Investment Office

P.O. Box 2749

Sacramento, CA 95812-2749

Telecommunications Device for the Deaf - (916) 795-3240

(916) 795-3400

May 15, 2006

AGENDA ITEM 5a

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** Emerging Market Manager Company Reports
- II. PROGRAM:** Global Equity
- III. RECOMMENDATION:** Information only
- IV. ANALYSIS**

Annually CalPERS' three emerging equity market managers report on portfolio holdings compared with geopolitical and investability factors as requested by the Investment Committee. The first such reports were presented to the Investment Committee at its April 14, 2003 meeting, its October 14, 2003 meeting, and then again at its May 16, 2005 meeting, each time incorporating the Investment Committee's requested enhancements. This year's enhancement includes a detailed comparison of the managers' rejected holdings versus the other managers' holdings as shown in Attachment 1. The managers' detailed reports are shown in Attachment 2 through 4.

Staff's Summary of the Reports

The managers' reports highlight 20 companies as having failed CalPERS' geopolitical and investability factors. Of these rejected companies, the managers agreed 6 companies were uninvestible. (Please see Attachment 1 for a detailed comparison of CalPERS' three emerging market managers' rejected holdings versus the other managers' holding.) Of the remaining 14 companies, the managers had differing judgments as to investability. Specifically:

- Out of Alliance Bernstein's 83 portfolio holdings, 2 holdings were rejected by Dimensional Fund Advisor (DFA) and/or Genesis. These companies were rejected due to concerns about property and shareholder rights as well as corporate social responsibility.

- Out of DFA's 433 portfolio holdings, 11 were rejected by Alliance Bernstein and/or Genesis. These companies were rejected due to concerns about property and shareholder rights, government influence on free markets, and transparency.
- Out of Genesis' 78 portfolio holdings, 3 were rejected by Alliance Bernstein and/or DFA. These companies were rejected due to concerns about shareholder rights, government influence on free markets, and corporate social responsibility.

Another notable finding of the reports was the concentration of problems within some countries. Of CalPERS' 19 permissible equity countries in 2005, only six have companies that were rejected due to CalPERS' geopolitical or investibility factors. These countries are: Brazil, Korea, Mexico, Philippines, South Africa, and Taiwan.

For eleven of the remaining thirteen countries, the managers did not report problems with geopolitical and investibility factors for a variety of reasons including DFA's more restrictive country list and Alliance's company valuation screens. These countries are: Argentina, Chile, Czech Republic, Hungary, India, Israel, Malaysia, Peru, Poland, Thailand, and Turkey. For the remaining countries, Jordan and Sri Lanka, the managers determined the countries' market capitalization was too small for investment so currently CalPERS has no investments in these two countries.

Background

At its November 13, 2000 meeting, the Investment Committee approved a recommendation to (1) hire through a focused manager solicitation process active emerging market equity managers who could demonstrate a transparent and well documented process for considering strategic factors; and (2) require annual reporting by those managers to the Investment Committee on the application of those strategic factors to the investments in CalPERS' portfolio.

At its April 16, 2001 meeting, the Investment Committee approved a solicitation document for the active emerging market manager search. That document stated that CalPERS was seeking active managers whose qualifications included a transparent and well-documented process for considering strategic factors of importance to the CalPERS Investment Committee, including geopolitical and investibility factors. These factors include:

1. transparency, including elements of a free press necessary for investors
2. political stability
3. progress towards the development of basic democratic institutions and principles
4. a strong and impartial legal system

5. property and shareholder rights
6. labor practices/harmful child labor
7. corporate social responsibility
8. compliance with the Global Sullivan Principles of Corporate Social Responsibility
9. compliance with the International Labor Organization (ILO) Declaration on Fundamental Principles and Rights at Work
10. market regulation
11. market volatility
12. currency risk
13. liquidity risk
14. repatriation risk
15. market openness to foreign investors
16. government commitment to free market policies
17. legal protection for foreign investors
18. trading and settlement proficiency
19. transaction costs

On January 9, 2002, the Investment Committee interviewed finalist emerging market manager candidates and selected Alliance Bernstein, DFA, and Genesis Asset Managers. Initial funding of the three new managers began in July 2002 and was completed in December 2002. The results of this transition from passive to active management were reported to the Investment Committee at its March 17, 2003 meeting.

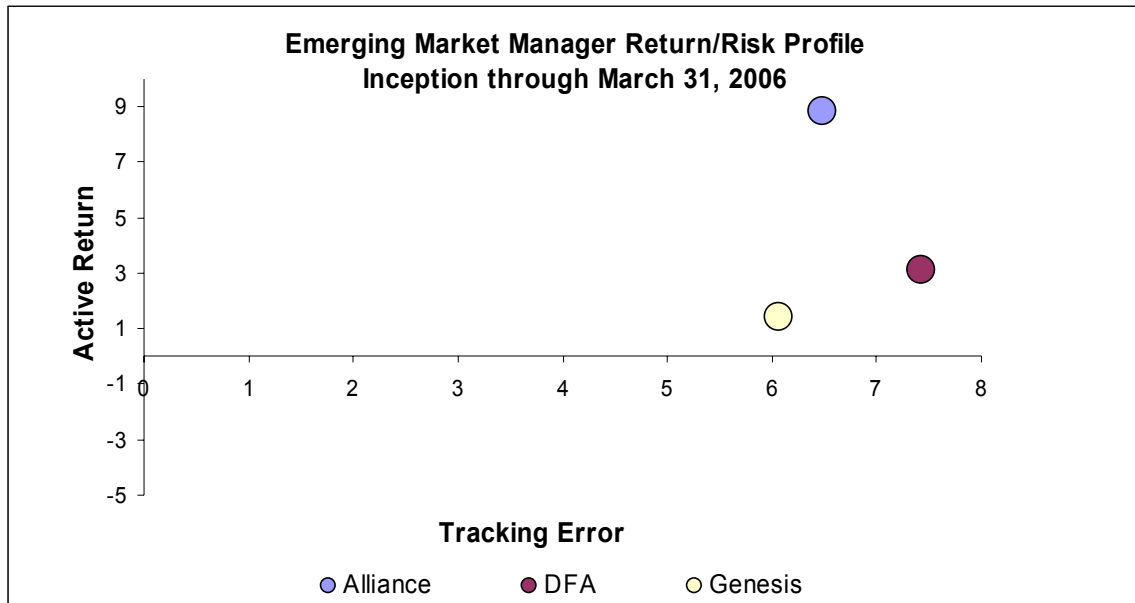
Performance

The table below shows the assets managed for CalPERS by each manager, the managers' total return since inception, and active return relative to the benchmark since inception.

As of March 31, 2006

| | Assets Managed for CalPERS | Total Return since inception of August 2002 | Active Return since inception of August 2002 |
|---------------------------|---------------------------------------|----------------------------------------------------------------|-----------------------------------------------------------------|
| Alliance Bernstein | \$1,644,258,450 | 40.78% | 8.47% |
| DFA | \$1,606,754,970 | 35.14% | 2.83% |
| Genesis | \$1,602,048,341 | 33.43% | 1.12% |

The chart below shows each manager's active return and risk profile since inception of August 1, 2002.



V. STRATEGIC PLAN:

This agenda item advances CalPERS Strategic Plan, Goal VIII: Manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and second, to minimize and stabilize contributions.

VI. RESULTS/COSTS:

There are no costs associated with this agenda item.

Geraldine Jimenez
Investment Officer III

Mary C. Cottrill
Senior Portfolio Manager

Christianna Wood
Senior Investment Officer

Anne Stausboll
Interim Chief Investment Officer